

1AP7 Rec'd PCT/PTO 24 APR 2006

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PATENT

ATTORNEY DOCKET No. 114594-02WOUS

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

Serial No.: 10/549,983 Confirmation No.: 3432
Applicant: Gordon L. Monsen, et al.
Title: FINANCING STRUCTURE
Filed: September 19, 2005
Atty. Docket: 114594-02WOUS

**CERTIFICATE OF REPLACEMENT MAILING AND
ENTITLEMENT TO FEBRUARY 16, 2006 MAILING (37 C.F.R. § 1.8(b))**

Commissioner for Patents
P.O. Box 1450
Alexandria, VA 22313-1450

Applicant requests that papers originally mailed and received by the PTO in February 2006 be given the benefit of earlier mailing.

A response to a Notification of Missing Requirements Under 35 U.S.C. 371 In the United States Designated/Elected Office ("371 Formalities Letter") was mailed on February 16, 2006. A return postcard was received, indicated a "received" date of February 21, 2006, copy enclosed. However, the papers have not appeared in the Image File Wrapper. It appears they were lost after being received in the PTO mailing room.

I certify that the following papers were originally deposited with the United States Postal Service on February 16, 2006 with sufficient postage as first-class mail in an envelope addressed to Commissioner for Patents, P.O. Box 1450, Alexandria, VA 22313-1450 and are entitled to a mailing date of February 16, 2006, and a "received" date of February 21, 2006:

- Transmittal of Fees and Executed Declaration in Response to "371 Formalities Letter"
- Declaration (3 pages, executed)
- Transmittal of Formal Drawings
- Formal Drawings (8 sheets)
- Request for Corrected Filing Receipt
- Information Disclosure Statement and Form PTO-1449
- 2 references

I certify that replacement copies of the above papers, and the following papers:

- Return Postcard

BEST AVAILABLE COPY

- This Certificate Of Replacement Mailing and Entitlement to February 16, 2006 Mailing (37 C.F.R. § 1.8(b))
- copy Postcard from February 16, 2006 stamped received "OIPE Feb 21., 2006"
- Certificate of Mailing from February 16, 2006
- Copy of Notification of Missing Requirements Under 35 U.S.C. 371 In the United States Designated/Elected Office ("371 Formalities Letter")

are being deposited with the United States Postal Service on April 18, 2006 with sufficient postage as first-class mail in an envelope addressed to Commissioner for Patents, P.O. Box 1450, Alexandria, VA 22313-1450.

Respectfully submitted,

WILLKIE FARR & GALLAGHER LLP

Dated: April 18, 2006

By: 

David E. Boundy

Registration No. 36,461

WILLKIE FARR & GALLAGHER LLP

787 Seventh Ave.

New York, New York 10019

(212) 728-8757

(212) 728-9757 Fax



UNITED STATES PATENT AND TRADEMARK OFFICE

UNITED STATES DEPARTMENT OF COMMERCE
 United States Patent and Trademark Office
 Address: COMMISSIONER FOR PATENTS
 P.O. Box 1450
 Alexandria, Virginia 22313-1450
 www.uspto.gov

U.S. APPLICATION NUMBER NO.	FIRST NAMED APPLICANT	ATTY. DOCKET NO.
10/549,983	Gordon L Monsen	114594-02WOUS

INTERNATIONAL APPLICATION NO.

PCT/US04/08361

I.A. FILING DATE

PRIORITY DATE

03/19/2004

38492
 WILLKIE FARR & GALLAGHER LLP
 INTELLECTUAL PROPERTY LEGAL ASSISTANTS
 787 SEVENTH AVE
 NEW YORK, NY 10019-6099

CONFIRMATION NO. 3432

371 FORMALITIES LETTER



OC000000017723415

Date Mailed: 12/29/2005

NOTIFICATION OF MISSING REQUIREMENTS UNDER 35 U.S.C. 371 IN THE UNITED STATES DESIGNATED/ELECTED OFFICE (DO/EO/US)

The following items have been submitted by the applicant or the IB to the United States Patent and Trademark Office as a Designated / Elected Office (37 CFR 1.495).

- Indication of Small Entity Status
- Copy of the International Application filed on 09/19/2005
- Copy of the International Search Report filed on 09/19/2005
- Information Disclosure Statements filed on 09/19/2005
- Request for Immediate Examination filed on 09/19/2005
- U.S. Basic National Fees filed on 09/19/2005
- Priority Documents filed on 09/19/2005

The applicant needs to satisfy supplemental fees problems indicated below.

The following items **MUST** be furnished within the period set forth below in order to complete the requirements for acceptance under 35 U.S.C. 371:

- Oath or declaration of the inventors, in compliance with 37 CFR 1.497(a) and (b), identifying the application by the International application number and international filing date.
- To avoid abandonment, a surcharge (for late submission of filing fee, search fee, examination fee or oath or declaration) as set forth in 37 CFR 1.492(h) of \$65 for a small entity in compliance with 37 CFR 1.27, must be submitted with the missing items identified in this letter.

SUMMARY OF FEES DUE:

Total additional fees required for this application is **\$215** for a Small Entity:

- \$65 Surcharge.

- The application search fee has not been paid. Applicant must submit \$50 to complete the search fee. Note a surcharge will be required if submitted later than commencement of the national stage (37 CFR 1.492(h)) and the basic national fee was not paid before July 1, 2005.
- The application examination fee has not been paid. Applicant must submit \$100 to complete the examination fee for a small entity in compliance with 37 CFR 1.27. Note a surcharge will be required if submitted later than commencement of the national stage (37 CFR 1.492(h)) and the basic national fee was not paid before July 1, 2005.

ALL OF THE ITEMS SET FORTH ABOVE MUST BE SUBMITTED WITHIN TWO (2) MONTHS FROM THE DATE OF THIS NOTICE OR BY 32 MONTHS FROM THE PRIORITY DATE FOR THE APPLICATION, WHICHEVER IS LATER. FAILURE TO PROPERLY RESPOND WILL RESULT IN ABANDONMENT.

The time period set above may be extended by filing a petition and fee for extension of time under the provisions of 37 CFR 1.136(a).

Applicant is reminded that any communications to the United States Patent and Trademark Office must be mailed to the address given in the heading and include the U.S. application no. shown above (37 CFR 1.5)

*A copy of this notice **MUST** be returned with the response.*

INDIA L EVANS

Telephone: (703) 308-9140 EXT 212

PART 1 - ATTORNEY/APPLICANT COPY

U.S. APPLICATION NUMBER NO.	INTERNATIONAL APPLICATION NO.	ATTY. DOCKET NO.
10/549,983	PCT/US04/08361	114594-02WOUS

Date: February 16, 2006

Atty. Docket No. 1:14594-02WOUS

FFICE

Application of Gordon L. Monsen, et al.

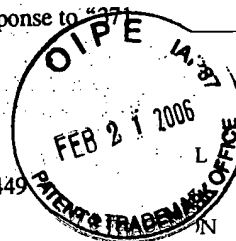
Serial No.: 10/549,983 conf'n 3432

Filed: September 19, 2005

For: FINANCING STRUCTURE

Enclosed

1. This postcard
2. Certificate of Mailing
3. Transmittal of Fees and Executed Declaration in Response to "37
Formalities Letter"
4. Declaration (3 pages, executed)
5. Transmittal of Formal Drawings
6. Formal Drawings (8 sheets)
7. Request for Corrected Filing Receipt
8. Information Disclosure Statement and Form PTO-1449
9. 2 references



PLEASE DATE STAMP AND RETURN TO ACKNOWLEDGE RECEIPT

NG RECEIPT

PATENT

ATTORNEY DOCKET No. 114594-02WOUS

IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

Serial No.:	10/549,983	Confirmation No.:	3432
Applicant:	Gordon L. Monsen, et al.		
Title:	FINANCING STRUCTURE		
Filed:	September 19, 2005	Art Unit:	3624
Atty. Docket:	114594-02WOUS	Examiner:	unassigned

CERTIFICATE OF MAILING (37 C.F.R. § 1.8a)

Commissioner for Patents
P.O. Box 1450
Alexandria, VA 22313-1450

I hereby certify that the attached

- Return postcard
- This Certificate of Mailing
- Transmittal of Fees and Executed Declaration in Response to "371 Formalities Letter"
- Declaration (3 pages, executed)
- Transmittal of Formal Drawings
- Formal Drawings (8 sheets)
- Request for Corrected Filing Receipt
- Information Disclosure Statement and Form PTO-1449
- 2 references

(along with any paper(s) referred to as being attached or enclosed) are being deposited with the United States Postal Service on the date shown below with sufficient postage as first-class mail in an envelope addressed to Commissioner for Patents, P.O. Box 1450, Alexandria, VA 22313-1450.

Respectfully submitted,

WILLKIE FARR & GALLAGHER LLP

Dated: February 16, 2006

By: 

David E. Boundy
Registration No. 36,461

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Title: FINANCING STRUCTURE
Filed: September 19, 2005 Art Unit: 3624
Atty. Docket: 114594-02WOUS Examiner: unassigned

**TRANSMITTAL OF FEES AND EXECUTED DECLARATION
IN RESPONSE TO 371 FORMALITIES LETTER**

Commissioner for Patents
P.O. Box 1450
Alexandria, VA 22313-1450

Pursuant to the "371 Formalities Letter" of 12/29/2005, Applicant transmits herewith an executed declaration.

Kindly charge additional filing/search/examination fees of \$ 150.00, and the late filing surcharge of \$ 65.00 (total \$ 215.00), to Deposit Account No. 23-2405, Order No. 114594-02WOUS.

If any fee is required, kindly charge any additional fee, or credit any surplus, to Deposit Account No. 23-2405, Order No. 114594-02WOUS.

Respectfully submitted,

WILLKIE FARR & GALLAGHER LLP

Dated: February 16, 2006

By: 

David E. Boundy
Registration No. 36,461

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(212) 728-9757 Facsimile

I certify that this correspondence, along with any documents referred to therein, is being deposited with the United States Postal Service on February 16, 2006 as First Class Mail in an envelope with sufficient postage addressed to Commissioner for Patents, P.O. Box 1450, Alexandria, VA 22313-1450.

04/28/2006 GFREY1 00000130 232405 10549983
01 FC:2617 65.00 DA

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Atty. Docket:	114594-02WOUS	Examiner:	unassigned

TRANSMITTAL OF FORMAL DRAWINGS

Commissioner for Patents
P.O. Box 1450
Alexandria, VA 22313-1450

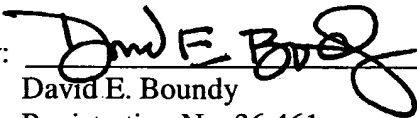
Applicant transmits 8 (eight) sheets of formal drawings. Fig. 5 is amended to conform to Fig. 5 of the PCT parent, which was incorporated by reference. The formal drawings introduce no new matter.

If any fee is required, kindly charge any additional fee, or credit any surplus, to Deposit Account No. 23-2405, Order No. 114594-02WOUS.

Respectfully submitted,

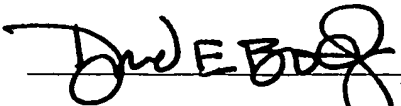
WILLKIE FARR & GALLAGHER LLP

Dated: February 16, 2006

By: 
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IN THE UNITED STATES PATENT AND TRADEMARK OFFICE

Serial No.:	10/549,983	Confirmation No.:	3432
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Filed:	September 19, 2005	Art Unit:	3624
Atty. Docket:	114594-02WOUS	Examiner:	unassigned

REQUEST FOR CORRECTED FILING RECEIPT

Commissioner for Patents
P.O. Box 1450
Alexandria, VA 22313-1450

Kindly issue a corrected filing receipt showing priority claims as follows:

- § 365(a) priority to International Application Serial No. PCT/US2004/008361, filed 19 March 2004
- § 119(e) priority to U.S. Provisional Application Serial No. 60/455,754, filed 19 March 2003, now abandoned

It is believed that no fee is due. If any fee is required, kindly charge any additional fee, or credit any surplus, to Deposit Account No. 23-2405, Order No. 114594-02WOUS.

Respectfully submitted,

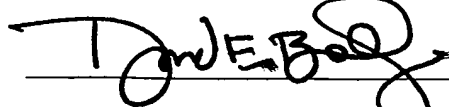
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Title: FINANCING STRUCTURE
Filed: September 19, 2005 Art Unit: 3624
Atty. Docket: 114594-02WOUS Examiner: unassigned

INFORMATION DISCLOSURE STATEMENT

Commissioner for Patents
P.O. Box 1450
Alexandria, VA 22313-1450

In accordance with 37 C.F.R. §§1.56, 1.97 and 1.98, Applicant wishes to make of record the items listed on the accompanying Form PTO-1449. Applicant respectfully requests the Examiner to fully consider the items and independently ascertain their teaching before issuance of the next action, and to make them of record in the file. The Examiner is also requested to initial and return a copy of the enclosed Form PTO-1449 to evidence such consideration.

1. Applicant has listed publication dates on the attached Form PTO-1449 based on information presently available to the undersigned. However, the listed publication dates should not be construed as an admission that the information was actually published on the date indicated. Applicant reserves the right to establish the patentability of the claims over any information provided herewith, and/or to prove that this information may not be prior art, and/or to prove that this information may not be enabling for the teachings purportedly offered.

2. The Examiner should be aware of copending application 11/063,064, both with respect to potential double patenting issues, and any art that may develop in that file. The Examiner may find it efficient and convenient to examine that application concurrently with this one.

3. To the knowledge of the undersigned, this Information Disclosure Statement is being filed before the mailing date of a first Office Action on the merits. No fee is due, pursuant to 37 C.F.R. §1.97(b)(3).

4. The Commissioner is hereby authorized to charge any additional fees that may be required for this Information Disclosure Statement, or credit any overpayment, to Deposit Account No. 23-2405, Order No. 114594-02WOUS.

Respectfully submitted,

WILLKIE FARR & GALLAGHER LLP

Dated: February 16, 2006

I certify that this correspondence, along with any documents referred to therein, is being deposited with the United States Postal Service on February 16, 2006 as First Class Mail in an envelope with sufficient postage addressed to Commissioner for Patents, P.O. Box 1450, Alexandria, VA 22313-1450.

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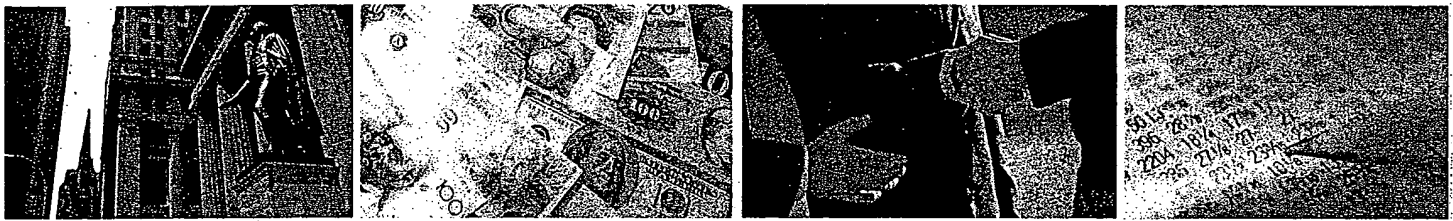
FORM PTO-1449		U.S. DEPARTMENT OF COMMERCE PATENT AND TRADEMARK OFFICE		ATTORNEY DOCKET NO. 114594-02WOUS		SERIAL NO. 10/549,983	
INFORMATION DISCLOSURE CITATION (Use several sheets if necessary)				APPLICANT Gordon L. Monsen, et al.			
				FILING DATE September 19, 2005		GROUP ART UNIT 3624	
U.S. PATENT DOCUMENTS							
EXAMINER INITIAL		DOCUMENT NUMBER	DATE	NAME	CLASS	SUBCLASS	FILING DATE IF APPROPRIATE
		5,802,501	Sep. 1, 1998	Graff	705	36	
		6,049,784	Apr. 1, 2000	Weatherly	705	38	
		6,192,347	Feb. 20, 2001	Graff	705	36	
		2005/0010517	Jan. 13, 2005	Lowenstein	705	37	Jul. 7, 2000
		6,847,946	Jan. 25, 2005	Blanz	705	38	Jan. 11, 2002
		2005/00144119	Jun. 30, 2005	Monsen	705	38	Feb. 22, 2005
OTHER DOCUMENTS (Including Author, Title, Date, Pertinent Papers, Etc.)							
		Bison Financial Group Inc., web page "Bond Street Capital Credit Tenant Lease Loans - Minimum \$10,000,000" http://www.bisonfinancial.com/loans/bsc_ctl.html (undated)					
		Mark Cecil, Credit Lyonnais Fixes Energy Deal, Bank Loan Report (November 6, 2000)					
		Celtic Financial Group, web page "Credit Tenant Lease ('CTL') Loans," http://www.bisonfinancial.com/loans/bsc_ctl.html (undated)					
		Dearborn Financial Services, Appraising Partial Interests, http://www.dearborn.com/download/frea8e/Chapter14.htm (January 2002)					
		F.W. Galaty, Modern Real Estate Practice, Real Estate Education Co., 15th ed. Chap. 16, pp. 250-264 (1999)					
		Jeffrey James, The Best of Leasing and Ownership Worlds, Puget Sound Business Journal, vol. 17 no. 41 p. 30 (Feb. 21, 1997)					
		Kathleen Kavanaugh, "February Program Review: The Fast Changing World of Real Estate Finance," web page of San Francisco Commercial Real Estate Women (CREW), www.crewsf.org/CrewView/2002/0302CrewView.pdf (page 2 of 7) (March 2002)					
		Jeffrey Keegan, Private Market Seeks Synthetic leases, Bank Loan Report, vol. 10 no. 19 pp. 8-9 (May 8, 1995)					
		KeyCorp and Norseman Group, Company Press Release, KeyCorp and Norseman Group Launch Credit Tenant Note™ Program (June 23, 2003)					
		Nancy R. Little, What You Need to Know About Financing With Synthetic leases, The Practical Real Estate Lawyer, vol. 15 no. 2 (March 1999)					
		Amity K. Moore, BNP Closes Syndication on Novel, Bank Loan Report, vol. 13 no. 2 p. 8 (January 12, 1998)					
		Gordon Monsen and Joseph Yiu, Single Tenant Net lease Guidelines to Achieve Maximum Financing, Briefings in Real Estate Finance, vol. 4, no. 1 (July 2004)					
		Scott R. Muldavin, Net Asset Value "Premiums," Real Estate Finance, vol. 14 no. 2 pp 74-78 (Summer 1997)					
		John C. Murray, Off-Balance Sheet Financing: Synthetic leases, Real Property Probate & Trust Journal, vol. 32, no. 2, pp. 193-253 (Summer 1997)					
EXAMINER				DATE CONSIDERED			

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Volume 4 Number 1
July 2004
ISSN 1473-1894

Briefings in Real Estate Finance

An International Journal



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STEWART
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Partner, Latham & Watkins, USA.

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James R. Webb Ph.D

Professor of Finance and Director of the Real Estate Research Center, College of Business Administration, Cleveland State University, USA.

John Whitehead

Tax Partner, Head of Real Estate, Travel and Tourism Tax Group, Deloitte & Touche, UK.

Richard K. Wood Jr.

Director, Asset Management & Investments, Real Estate Operations, IBM Corp., USA.

Joseph Yiu

Managing Director, The Norseman Group, USA.

Single tenant net lease guidelines to achieve maximum financing

Received (in revised form): 18th February, 2004

Gordon Monsen

is CEO, a managing director and founding member of The Norseman Group. He has over 22 years of varied experience in the capital markets. Prior to founding Norseman, he was a managing director of the Polestar Capital Group, whose assets were purchased and are now a part of The Norseman Group's product offerings. He had formerly been Chairman and Chief Executive Officer of Westmont Capital Corporation, a mortgage company with an originations volume that hit \$50m a month before the credit market implosion of late 1998. Gordon was a managing director at PaineWebber, now UBS/PaineWebber, from 1995 to 1997, where he was responsible for the securitisation and placement of more than \$4bn in asset-backed securities. He served as a managing director of Bear Stearns from 1991 to 1994, with responsibilities for trade support in the residential mortgage business and the development of long-term credit default and prepayment models. He joined Bear Stearns from Telerate/Dow Jones, where he had been President of the Mortgage Division responsible for all mortgage products and markets. He was offered this job after completing the development of the Advanced Factor Services, a short-term mortgage prepayment model, which he sold to Telerate. From 1979 to 1984, Gordon was a senior vice president of Citicorp, responsible for the development of trading systems and analytics in the mortgage and fixed income groups. His experience in the structuring, rating and sales of new esoteric asset-backed securities over the past ten years was the basis for the creation of the Norseman Mezzanine Loan product. He holds a Bachelor of Arts degree from Trinity University and his work has been widely published in the mortgage market. Among his publications are 'Industry dislocation creates market opportunities', *National Mortgage News*, 22nd February, 1999; 'No equity debt consolidation loan performance', *Asset Backed Securities Week*, December, 1996; 'Effects of homeowner creditworthiness on mortgage refinancings', Federal Reserve Bank of New York, July, 1996; and 'The new thinking on prepayments', *Mortgage Banking*, October, 1992. Gordon has been a speaker at numerous industry conferences and has contributed chapters to several mortgage analytics handbooks.

Joseph C. Yiu

is a managing director and founding member of The Norseman Group. Prior to joining the Group in 2002, he was an associate director at the Polestar Capital Group, a speciality finance company providing tenant improvement financing to commercial office properties. At Polestar, Joseph headed the analytics department for both the capital markets and origination efforts. Prior to this, he was an analyst in a real estate opportunity fund at Credit Suisse First Boston. The opportunity fund focused on the acquisition of distressed loans and non-core REIT assets, redevelopment and lease-up opportunities. His main responsibilities included underwriting and valuing prospective acquisitions. Joseph analytical background, coupled with his extensive experience in commercial real estate and structured finance, was instrumental in the creation of the Norseman Mezzanine Loan Product. He has been responsible for developing Norseman's preliminary securitisation models, term sheet and loan documentation, and loan pricing models. He is a graduate of The Wharton School at the University of Pennsylvania with a BS degree in Real Estate and Finance. His work was recently published in the *Journal of Corporate Real Estate*, in July 2003.

Gordon Monsen
CEO

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Tel: +1 973 947 0304
Fax: +1 973 947 0319
E-mail: gmonsen@norsemangroup.com

Abstract

Developers and acquirers of single credit tenant properties sometimes overlook lease terms that can dramatically affect the ultimate capital leverage — or lowest and most accretive interest rate — that could be achievable on a particular property. Where remaining lease terms are greater than 15 years, this is a bit less of an issue; however, where terms are less than 15 years, it is critical. These lease issues can reduce the maximum leverage attainable based on the cash flows by more than 25 per cent. These issues are subtle and part of corporate America's push to sign shorter, more flexible leases than the 20-year bond-type leases that were common five to ten years ago. Real estate professionals cannot be faulted for not focusing on the financing implications of the structural nuances of these lease provisions and the financial constraints they create in the capital markets. This paper outlines the perspective of lenders and the capital markets on these lease issues and provisions to help developers and acquirers achieve the optimal capital structure and understand the specific economics of lease terms that impinge on the capital structure.

Keywords:

credit tenant note, early termination option, offsets and abatement, roof and structure, free rent, partial casualty, casualty and condemnation

INTRODUCTION

Single tenant properties with lease terms of less than 15 years are not good candidates for credit tenant lease (CTL) financings because the cash flows' present value is often less than the advance rate of a traditional 30-year mortgage and is always less than owners have come to expect from CTL financing.

As can be seen in Table 1, a CTL financing cannot provide attractive financing for lease terms of less than 15 years. The shaded boxes represent total CTL leverage realised in lease terms of less than 15 years. A higher cap rate and longer lease term translates into more cash flow and overall leverage. The CTL financing fully amortises over the lease term at a rate of 6.50% and a debt service cover ratio (DSCR) of 1.00. For the purposes of the analysis, the loan rate of 6.50% was not adjusted to reflect the average life of the

Table 1: Examples of CTL financing for lease terms of less than 15 years

Lease term	8.00%	Cap rates 9.00%	10.00%
7	5.88%	6.13%	4.13%
10	6.73%	6.70%	4.33%
12	6.92%	6.83%	4.39%
14	7.21%	6.91%	4.44%

CTL loan. In addition, the analysis assumes a triple-net (NNN) lease with no rent escalations.

In today's cap rate environment, which hovers in the 8.00 per cent to 9.00 per cent range for credit tenants, a CTL financing provides the borrower with leverage of 43.88 per cent to 81.12 per cent. Since a CTL zeros out the cash flow, this is not attractive to borrowers. In this instance, borrowers have had to look to traditional mortgage lenders for life company or conduit loans with 20–30-year amortisations. While conduit lenders may provide slightly higher advance rates (loan to value — LTV) than life companies, both lending sources *usually* require final maturities co-terminus or inside the lease expiration. Furthermore, while the long amortisation schedules keep debt service costs down and increase the cash flow available to returns, conduits generally limit advance rates to 80 per cent LTV and life companies and other lenders to 70–75 per cent for single tenant properties. In 2003, and continuing into 2004, many lenders have been reducing advance rates and 65–70 per cent LTV loans have become more common.

Historical review of CTL financing

Given that many single tenant properties have tenants that are investment grade, why then have these lenders reduced advance rates, especially when compared with what can be achieved through a CTL financing on a 15–20-year single tenant leased property? The answer is simple: the CTL financing must be fully amortising within the term of the lease to shift the credit from the borrower to the tenant. The lender (investor) is only betting on the tenant's probability of default. Leases that are for 15 years or less are not financed with CTLs, because the present value of the cash flows over the lease term provides the borrower with insufficient leverage. For example, a single tenant property trading at a cap rate equal to 10 per cent with a constant level of cash flow of \$5,000,000 for ten years will yield the borrower debt proceeds equal to 69 per cent LTV, assuming that 95 per cent of the cash flows are discounted at 6.50 per cent. By varying the in-going cap rate and the length of the lease, it can be seen that a lease term of less than 15 years does not provide high leverage (> 95 per cent) for the borrower.

Due to the high vacancy levels in several US markets, coupled with the deterioration in corporate credits during 2003, senior lenders seemed to slightly reduce these advance rates to the point where 65–70 per cent LTV loans have become more standard. With a shorter lease term and a 20–30-year mortgage, the loan is not fully amortising within the remaining lease term, and there is typically a 40–60 per cent balloon (remaining principal balance) at maturity. For the loan to be paid off at maturity, the tenant either has to renew the lease or the borrower (owner) will need to re-let the property to another tenant. Recognition of the uncertainty of renewal causes lenders to reduce the leverage that they are willing to provide in order to be more comfortable that the borrower will have the ability to refinance the mortgage. It also causes lenders to implement policies that reserve cash to ensure that any expenses

associated with re-letting the property are available at the time the tenant gives notice that they are not renewing, which is usually a reasonable period before actual lease termination. This is either done by reserving cash each year or by sweeping all of the excess cash flows in the last year or two. The result of these concerns and policies is, obviously, much lower proceeds than one would think a single credit tenant property deserves.

SINGLE TENANT MEZZANINE LOANS ONLY BECAME AVAILABLE IN 2003

Replace equity with cheaper mezzanine capital

Until today, maximum leverage obtained on a single tenant property with lease terms of less than 15 years was directly correlated to the mortgage lender's advance rate, leaving the remaining 25–35 per cent of the capital structure to be funded with precious landlord equity. Borrowers could not look to traditional forms of mezzanine debt to bridge the equity gap, mainly because the rates (12–15 per cent) were far too high relative to the strong creditworthiness of even lower investment grade tenants. When Norseman introduced its credit tenant note (CTNTM) financing in early 2003, it did so at rates that reflected a tenant's specific credit, resulting in a much lower interest rate than any other mezzanine loan available. The Norseman CTNTM is a fully amortising loan, however, and therefore has a cash flow constant only slightly lower than the rate — and constant — of traditional mezzanine loans. The Norseman CTNTM loan is very similar to a CTL in a mezzanine position in a landlord's capital structure. The loan is the present value of the *excess cash flows* (NNN rent minus mortgage payment) over the shorter of the lease or mortgage terms. The CTNTM rate is approximately 200–500 basis points (AAA-BB credits) higher than the tenants' senior unsecured borrowing rate for the same average life loans. The Norseman CTNTM loan behind a traditional 20–30-year mortgage creates total capital leverage (95 per cent LTV) very similar to a CTL financing for a 20–25-year bond-type lease. There are several lease issues, however, that can dramatically reduce the amount of secondary financing that a given lease cash flow can support. These issues are considered in the context of a \$12,500,000 property occupied by a single A-credit tenant with a ten-year lease term. The initial rent of \$1,031,250 escalates by 1 per cent per annum, which translates to an in-going cap rate equal to 8.25 per cent (see Table 2).

Table 2: General asset assumptions for the case study

Purchase price	\$12,500,000
Tenant credit	A
Cap rate	8.25%
Lease term	10
NNN rent	\$1,031,250
Rent escalations per annum	1.00%

Efficient capital structure for single tenant properties

MAXIMUM LEVERAGE FOR THE CASE STUDY

Maximum leverage is obtained by getting the longest possible amortisation term on the senior mortgage, because the longest term leaves the most excess cash flow for mezzanine financing. In the case study, a ten-year first mortgage maturity with a 30-year amortisation schedule is assumed. As discussed earlier, the senior loan amortisation is dependent on the value, use and location of the property, plus the tenant's credit, and the length of the lease term. In order to obtain maximum leverage, the *base case assumes a pure NNN lease where the landlord bears no responsibilities under the lease and the tenant is unable to terminate except in the event of casualty and condemnation*. The mortgage assumptions described in Table 3 create significant excess cash flows available to service Norseman's mezzanine loan. A 70 per cent advance rate, coupled with a 30-year amortisation generates significant excess cash flow available to service a Norseman mezzanine loan. As can be seen later in this paper, the senior lender underwrites a balloon equal to 55 per cent of the initial property value. A 59 per cent balloon typically means that the senior lender is comfortable that his loan will get repaid in the event that the tenant does not renew its lease at loan maturity. The size of the balloon is directly correlated to the market dynamics and reusability of the asset.

A senior mortgage loan constant of 7.46 per cent is accretive to the lease cash flow with an initial yield (cap rate) of 8.25 per cent. Table 4 illustrates the excess cash flows available to pay the Norseman CTNTM mezzanine loan from a NNN lease with 1.00 per cent rent escalations per annum.

The Norseman CTNTM mezzanine loan proceeds are determined by present valuation of the excess cash flows over the shorter of the lease or mortgage maturity. In this example, there are ten years of excess cash flow available to the Norseman. The CTNTM loan rate is commensurate with the creditworthiness of the tenant. An A-rated tenant translates into a loan rate of 6.65 per cent (note that the CTNTM rate for an A-credit tenant is only 40 basis points higher than the 6.25 per cent rate for the first mortgage). Assuming a 1.00 DSCR, Norseman can raise \$3,157,360 of mezzanine debt or an additional 25.26 per cent of the capital stack. The total leverage

Table 3: Mortgage assumptions for the case study

Mortgage LTV	70.00%
Mortgage rate	6.25%
Mortgage amortisation	30
Mortgage term	10
Balloon LTV	59%
Debt service coverage	1.00
Loan constant	7.46%
Mortgage proceeds	\$8,750,000
Mortgage payments	\$652,775
Mortgage balloon	\$7,337,659

Table 4: Access cash flows available for Norseman mezzanine loan

Years	Free and clear cash flow (\$)	Mortgage payment (\$)	Excess cash flow (\$)
1	1,031,250	652,775	378,475
2	1,046,719	652,775	393,944
3	1,062,420	652,775	409,645
4	1,078,356	652,775	425,581
5	1,094,531	652,775	441,756
6	1,110,949	652,775	458,574
7	1,127,613	652,775	474,839
8	1,144,528	652,775	491,753
9	1,161,695	652,775	508,921
10	1,179,121	652,775	526,346

High loan constant versus low loan rate

(Table 5) realised is 95.26 per cent LTV or \$11,907,360. The borrower contributes \$592,640 or 4.74 per cent of the equity to buy a \$12,500,000 property. The maximum financing shown in Table 5 represents a 30-year mortgage and a ten-year fully amortising Norseman CTNTM. The blended amortisation of the two loans equals 25 years. Although Norseman's loan constant individually equals approximately 14.28 per cent, the blended constant is 9.27 per cent, which is 1.02 per cent more than the property's ingoing cap rate of 8.25 per cent. Although the blended loan constant is not accretive to the cash flow, the low blended loan rate of 6.36 per cent and 95 per cent leverage will tremendously increase the project's internal rate of return. The base case study assumes a pure NNN lease. As the lease terms deviate from those of a pure NNN, the overall financing will be incrementally lowered.

OPTIMISING LEASES FOR CAPITAL MARKETS

As lease terms deviate from those of a pure NNN, the overall financing will be incrementally lowered. The following section highlights those lease issues that often negatively affect the maximum leverage attainable.

Effects of multiple lease issues on proceeds

While each of the major lease issues that will be discussed can have a significant impact on the total financial leverage possible for a

Table 5: Maximum financing for the case study

Total LTV	95.26%
Total rate	6.36%
Total amortisation	25
Total term	10
Balloon LTV	59%
Debt service coverage	1.00
Blended loan constant	9.27%
Total proceeds	\$11,907,360
Total payments	\$1,103,718
Total balloon	\$7,337,659

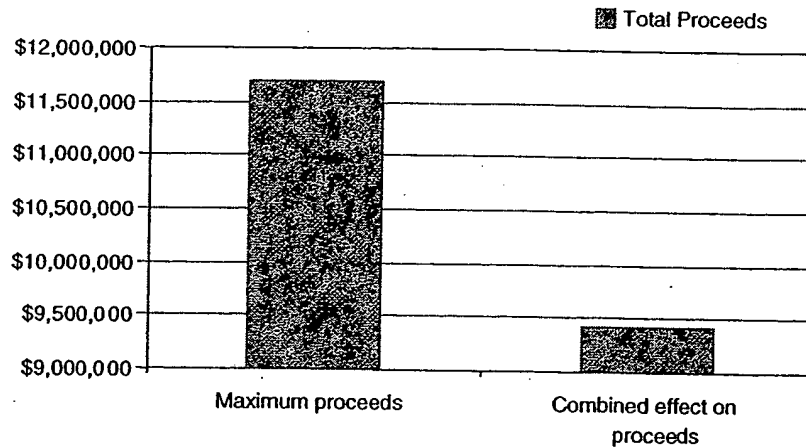


Figure 1: \$11,907,360 maximum proceeds versus \$9,610,262 reduced proceeds from the following lease issues: early termination option, rent abatement and capital reserves associated with roof and structure responsibilities

Negotiating financeable leases

given asset, the impact of having several lease issues associated with an asset can make it impossible to leverage an asset above that level which can be obtained by a traditional senior 30-year mortgage alone. If an owner gives the tenant an early termination option, rent abatement rights and retains roof and structure responsibility, this can become the case. Figure 1 compares the maximum proceeds (95 per cent LTV) already discussed with the debt that can be raised should the three major lease terms deviate from pure NNN (77 per cent LTV).

Early termination options (major)

Many corporate tenants in the past few years have negotiated shorter term leases and leases with early termination options (ETO), which have penalties associated with their exercise that are often quite expensive. The problem is that lenders universally adjust the lease expiration date to the date of the ETO and few give any credit to any penalty that would accrue if the tenant exercised that option. This can be disastrous to the ultimate financial leverage for two reasons. For example, consider a ten-year remaining lease term with a five-year ETO. First, the senior lender is less willing or unable to offer the higher LTV loan, because there is very little amortisation in the first five years, making the loan almost an interest-only loan that puts an even higher burden on the borrower to come up with the balance due at maturity. Secondly, it reduces the proceeds that a Norseman CTNTM can add, since there is significant cash flow to present value. It is clear that, regardless of any penalty charged for an ETO in the lease, *landlords should do everything in their power to*

Reducing landlord responsibilities

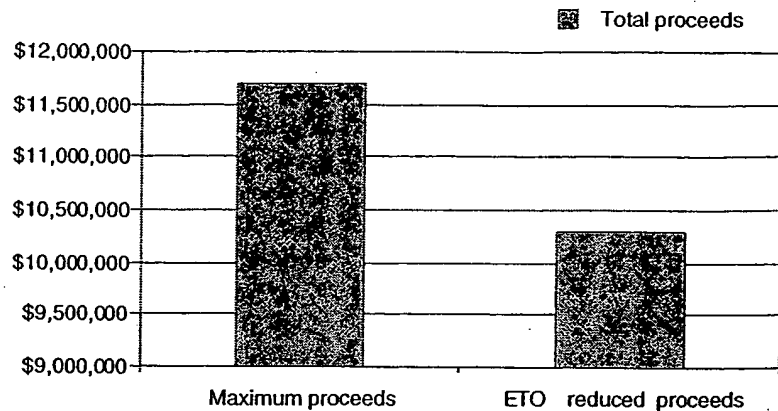


Figure 2: Maximum versus early termination option reduced proceeds

avoid giving the tenant this option (see Figure 2). An early termination option reduces the overall financing proceeds because the Norseman mezzanine loan must be co-terminus to the date of the ETO. The maximum financing proceeds are reduced to \$10,438,044 with the ETO. For simplicity, the analysis solely deals with the ETO impact on the Norseman mezzanine loan. It is highly accurate to assume similar limitations (shortening of amortisation schedule) and impact on the senior financing.

Roof and structure

Perhaps the most common obligation transferred to, or retained by, the lessor is that of roof and structure. Lenders need to be sure that the owner will have the capital to make any repairs or maintenance required to satisfy these obligations. If the lease does not completely specify the obligation, the lenders will have to make a conservative estimate on what these costs might be and will either reduce proceeds or, as with ETO, sweep cash flows to reserve for these costs. There are cases where the parties agreed to fairly specific limits to these costs and whether they are wholly the responsibility of the owner or shared on some specified basis with the lessee. As an example, limiting the landlord's maximum capital cost per year enables lenders to precisely reserve the specific expense exposure, rather than estimating an always much higher cost. Wherever possible, it would be better all round for the lessor not to have these obligations, even if it means slightly lower rents. The trade-off can be analysed in several ways, but lower rent is usually preferable. There are two reasons for this. First, no capital costs may be necessary during the term of the lease for roof and structure, yet the presence of the obligation will cause lenders to skim cash flow to reserve for it. Secondly, the lower net cash flow from lower rents still usually provides more net cash flow for debt service than the net

Creating predictable cash flows

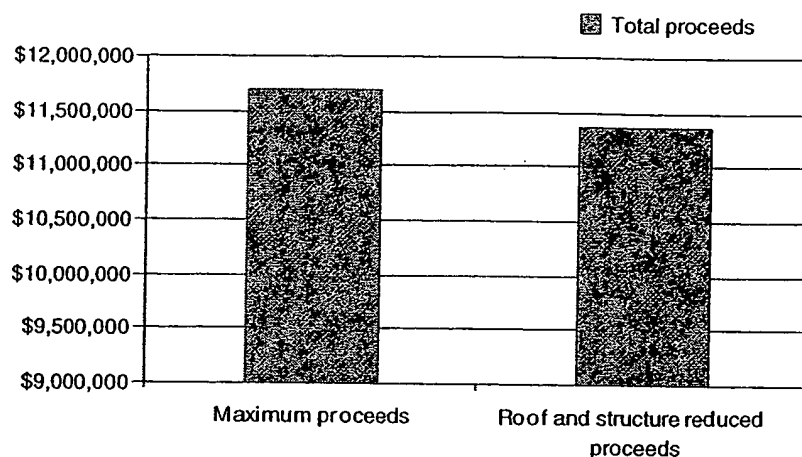


Figure 3: Maximum versus structural reserve reduced proceeds

cash flow after the lender reserves for anticipated capital expenses. Figure 3 displays the reduction in overall financing proceeds. The analysis assumes there is a capital reserve requirement of \$50,000 per annum. Capital reserve requirements for roof and structure obligations in the lease reduce financing proceeds to \$11,550,428 or 92 per cent LTV. As can be seen from Figure 3, the impact on capital reserve requirements is not as detrimental as an early termination option in the lease.

Offsets and abatements

Any lease provision that gives the tenant the ability to offset or abate its rent obligation should be as clear and specific as possible, and ideally should have some ability for the landlord to recover the abatements upon some event occurring. In the event that the lease does not allow the landlord to recover the abatements, Norseman will reduce excess cash flow available for debt service accordingly. The amount of abatement is typically specified in the lease. The impact of the rent abatement is very similar to capital reserve requirements, although rent abatement penalties are typically higher.

Free rent

Owners may give a prospective lessee 6–12 months of free rent as an inducement to entering into a long-term NNN lease. While this may seem reasonable and attractive, and may even result in the same total rents being paid over the full lease term, it will seriously reduce the total financing potential of the deal. This is because any senior or mezzanine loan will need to be repaid from the date the loan is made. This means that there will be negative amortisation, which effectively increases the owner's basis in the deal, and this increase will be reserved out of the proceeds from the loan, thereby

decreasing the net proceeds of the loan. The effect is lessened where the loan is interest only in the first year rather than fully amortising.

Partial casualty

In the event that some portion of the premises becomes untenable for some reason, tenants often look for the owner to reduce rent on some *pro rata* basis, when the condition persists. Unless the owner can obtain some form of lease enhancement insurance that will cover the loss of rent in this event, there needs to be some way in which the owner can remediate the problem in a specific, clear-cut and straightforward manner. If there is the potential for an indeterminate reduction in net rents, the senior lender could reduce the advance rate and Norseman would have no stable cash flows to underwrite. The best solution is for the tenant to retain the responsibility or to insure against it. An acceptable alternative would be some cap on the rent reduction. Again, any potential for less cash flow, and especially one with uncertainty of any sort, will result in lower combined loan proceeds.

Patching up lease holes with insurance

Obligations of closing out constructions

There are many leases that have surviving owner obligations relating only to the construction period, and these obligations require that the lenders obtain estoppels from the tenant verifying that they no longer exist. It is always better when the original lease contains specific language and triggers that terminate these obligations once construction has been completed or the obligation otherwise fulfilled and in no case longer than one year after occupancy. In general, all owner or landlord obligations that are included in a lease need to have very clear termination or fulfilment language. In the absence of such language, lenders must either obtain estoppels or reduce proceeds.

Casualty and condemnation

Typically, all leases that are not bondable enable the tenant to vacate the premises in the event of casualty and condemnation. Both the senior lender and Norseman will require the landlord to buy some sort of lease enhancement and/or property insurance sufficient to cover the initial loan proceeds. Generally, the cost of this insurance is a one-off fee that ranges from 0.5 per cent to 1.5 per cent of the total loan proceeds. Figure 4 shows that rent abatement rights will reduce excess cash flow available to debt service. The analysis assumes that the tenant has the ability to reduce \$150,000 of rent per annum. The rent abatement rights reduce financing proceeds to \$10,836,565 or 87 per cent LTV.

Stranger lease results in 90 per cent-100 per cent financing

CONCLUSION

The Norseman CTNTM loan was only introduced to the marketplace last year and so the uses of the loan were not entirely clear to the landlord community. Norseman wanted to identify

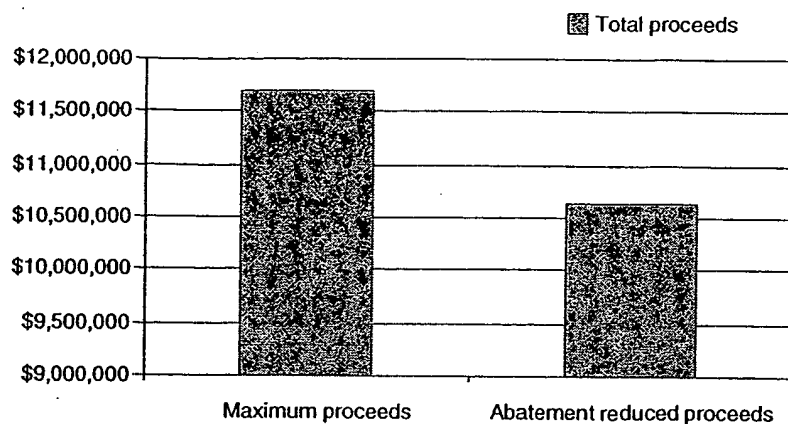


Figure 4: Maximum versus rent abatement reduced proceeds

those lease provisions that reduce not only Norseman financing proceeds, but those of the senior lender as well. Rent abatement rights, early termination options and structural reserves all reduce the excess cash flows available to debt service. As landlords/developers negotiate new leases or evaluate leases in acquisitions, they must be wary of the negative impact that these lease variables can have on maximising financing or minimising their cost of financing. As demonstrated in this paper, if a developer is able to prevent these negative covenants from appearing in the lease, there is a high probability that he will reap maximum leverage, ranging from 90–100 per cent financing.

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Press Release

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KeyCorp and Norseman Launch Credit Tenant Note(TM) Program

CLEVELAND, June 23 /PRNewswire-FirstCall/ -- KeyCorp's real estate capital line of business and The Norseman Group today announced the launch of a new program that extends the benefits of traditional Credit Tenant Lease (CTL) financing to commercial properties with lease terms that are too short to fully leverage the tenant's credit. CTL financing primarily emphasizes the credit quality of the tenant and the lease structure in order to establish a cost of borrowing.

The cornerstone of this new program is the proprietary Key-Norseman Credit Tenant Note(TM) (CTN(TM)) product, which allows landlords and owners of single-tenant commercial properties to create an additional, secondary source of capital by leveraging income from triple-net or bond leases. Created by Norseman and sponsored by KeyBank Real Estate Capital's Private Equity Group, the CTN(TM) structure enables Key to underwrite single-tenant properties with triple-net or bond leases of 15 years, or less based on their remaining net lease income.

Like the CTL, the CTN(TM) financing has several advantages over traditional real estate financing, including tighter pricing, lower debt service coverage ratios, maximum loan proceeds and greater liquidity. Unlike the CTL, this unique program is non-recourse for the owner-borrower, and allows them to monetize 100 percent of the excess cash flow after servicing senior debt requirements. It has no loan to value restrictions, minimal collateral requirements, no lien on the real estate, and carries less refinancing risk than traditional mezzanine financing because the note is underwritten based on real lease income. The Credit Tenant Notes(TM), which follow any traditional 25-to-30-year first mortgage, are eventually bundled as "assets," securitized, and sold to institutional investors.

The best opportunities for this program are instances where regional commercial real estate owners and developers seek to monetize their existing property investments, obtain incremental financing for acquisitions, or replace short-term construction or bridge financing with longer-term financing that is better aligned with property cash flow. Also benefiting from the program would be major real estate investment advisory firms whose clients wish to facilitate purchase or sale transactions.

Features of the CTN(TM) product include:

- Full amortization over the remaining term of the lease
- Rates priced significantly lower than traditional mezzanine lenders
- Instant liquidity for single tenant lease transactions
- No real estate collateral or assignment of partnership interests

According to Paul Horning, SVP of Key's Private Equity Group, the CTN(TM) product was created to fill a void in the market. "CTN(TM) financing is a reasonable source of debt that is designed to bridge the large financial gap by financing excess cash flow after servicing the mortgage payments," he said. "With the addition of this product, Key now offers the most comprehensive set of lending products to the commercial real estate industry."

"This loan product provides convenient financing and optimum proceeds," added Gordon Monsen, managing director and CEO of The Norseman Group. "It can be used to finance cash flows and properties where it was previously difficult to increase financing leverage, such as dark buildings, properties with significant above market rents, and properties with less than 15 years remaining on the lease term."

Beginning this month, Key and Norseman will jointly market the CTN(TM) Program through Key's national distribution platform, which includes 29 real estate offices nationwide. Key has committed substantial stand-by funds to support the program and anticipates offering quick transactional turnaround and loan terms specifically tailored to individual property requirements.

The Norseman Group, LLC is a real estate investment firm located in Jersey City, New Jersey, specialized in providing secondary real estate and tenant improvement financing to owners and developers of commercial properties. Norseman developed the Credit Tenant Note(TM) financing structure and has filed for a U.S. patent.

KeyBank Real Estate Capital (KeyCRE) is the nation's fourth-largest commercial real estate lender with approximately \$10 billion in annual financings. It provides construction and interim loans, private equity, commercial mortgages, investment banking and loan sales and syndications services nationwide for virtually all property types. Its 630 financing professionals serve a national client base through 29 locations in major U.S. markets. KeyCRE is a business unit of

KeyBank National Association, a subsidiary of Cleveland-based KeyCorp (NYSE: KEY), one of the nation's largest bank-based financial services companies, with assets of approximately \$86 billion.

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